

**IMPROVING THE MUNICIPAL
ASSET MANAGEMENT SYSTEM
IN DOBRICH**

**PART 2: INFORMATION
REQUIREMENTS FOR MANAGING
MUNICIPAL REAL PROPERTY
ASSETS**

Prepared for



Prepared by

Olga Kaganova

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THE URBAN INSTITUTE

2100 M Street, NW
Washington, DC 20037
(202) 833-7200
www.urban.org

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IMPROVING THE MUNICIPAL ASSET MANAGEMENT SYSTEM IN DOBRICH

PART 2: INFORMATION REQUIREMENTS FOR MANAGING MUNICIPAL REAL PROPERTY ASSETS

I. INTRODUCTION

This report represents the second part of the Improving the Municipal Asset Management System in Dobrich Project and provides practical suggestions concerning information formats needed to improve asset management in the City.

The first report focused on analysis of existing asset management practices. In particular, it described the main types of municipal non-residential real property and the processes this property is involved in; clarified the size and characteristics of portfolios owned by the City and relationships among these portfolios; identified problems and shortcomings in asset management, and suggested possible improvements.

Contemporary computerized information systems allow data to be maintained and analyzed at all levels of property and asset management, from tracking daily expenses related to any particular building to financial forecasts concerning an entire portfolio, for any time horizon of the forecast. However, development of such a comprehensive system is a process rather than a one-time action, and this process should be planned and prioritized according to needs and resources available.

In Chapter II of this report, some sample information forms for data collection at property and portfolio levels are suggested. This data, once collected, would provide a basis for informed and rational decision-making concerning asset management and specific properties (approaches to such rational decision-making were described in the first report). *However, it should be pointed out that the implementation of such a database would require some important administrative decisions concerning asset and property management; only then would it be possible to collect the required data.* Required administrative changes are associated mainly with the need to implement separate accounting of all incomes and expenses associated with each property.¹

Chapter III discusses more long-term information needs and analytical tools which would be applicable as soon as the real estate market becomes more developed and the national economy stabilizes. Some information required for such long-term analysis should be collected systematically over an extended period of time. Therefore, it would be very useful to begin its gathering as soon as possible, and this is why this chapter is included in the report.

¹ For more discussion of this and other issues, see Part 1 report.



The report does not consider any issues of administrating asset management information.

II. INITIAL INFORMATION TO COLLECT, MAINTAIN, AND ANALYZE

As discussed in the first report, the basic information needs of the property owner (municipality) include:

- C Inventory data on each property.
- C Complete income and expense data.
- C Data on the market value of the property.
- C Data on debt secured by the property.

Because the City has several different property portfolios, it is fundamentally important to set up unified standards for all portfolios in order to make information from different portfolios compatible and comparable.

There are two main levels of information: the property level and the portfolio level. From the point of view of their contents, the portfolio level summarizes and generalizes data from the property level. But considering the practical development and implementation of the information system, both levels may be designed and fulfilled simultaneously in many instances.

There is no commonly accepted information system for property and asset management, nor are there any common standards. Many asset management companies use products developed in-house. At the same time, there is a growing competition among software companies which offer comprehensive computer packages for property and asset management companies.

Forms for data collection are suggested in this report reflect some local specifics, but not all of them. The forms may be modified if some additional information is deemed important to include; they may be re-shaped or re-assembled for users' preferences or convenience; finally, many other forms may be added. So, the suggested set of forms provides only a framework for a core system, and more technical work should be done to: (1) develop this model up to an implementation level of detail, and (2) adapt it to the specifics of some portfolios.

Figure 1 shows information flows among different key blocks (forms) of the database. Comments on these forms are presented below. All of them are in Microsoft Excel. A legend in each form provides explanations for all entries that are not self-explanatory. Some forms have only an information recording function, while others are complimented by analytical characteristics or at least by descriptions regarding how they should be calculated. Analytical sections of the forms are located below the legend in those forms where they are presented.

Form 1: Property Inventory (Portfolio Level)

The purpose of this form is to keep systematic records on leasable municipal properties. This system does not substitute for the cadaster and for this reason it does not provide any complete data on physical characteristics of properties. We suggest two sub-formats for this form: Form 1A, in Annex 2, is for properties where rentable space is inside buildings. Form 1B, in Annex 3, is for properties where rentable space is land. For more complicated cases, when one property contains both, units in buildings and separately rentable land, these two sub-formats should be unified.

Two blocks of information in this Form 1 should be specially noted. First, information on a number of other (different from the City) co-owners in the property and a share of municipal property is useful for monitoring dynamics of municipal involvement in multi-owned properties and developing a strategy for such involvement. Second, information on the market and balance values and debt obligations is critical for evaluating profitability of each property. Given the large number of municipal properties, this form would be updated permanently, on a property-by-property basis. For this reason, the form should contain information on when data on each particular property was updated (column 4).

Form 2: Rent Roll (Property Level)

This form, in Annex 4, provides a possible format for standardized ongoing records on lease agreements. It should be updated each time changes with tenants or leases take place. This form is an information basis for Form 3.



Form 3: Schedule of Vacancies and Revenues, by Months, for Year 1998 (Property Level)

This form, in Annex 5, allows monitoring on a monthly basis two important groups of characteristics: vacancies and revenue. Characteristics of revenue monitoring include:

- ! Potential rent income (i.e., the rent income that would be received if all units at a property were rented out for a market level rent, and the occupancy rate was typical for this kind of property on the market).
- ! Scheduled rental income (i.e., the rental income that should be received in accordance with existing lease agreements).
- ! Collected rental income (i.e., the rental income actually received from tenants).

The form should be updated monthly and finalized after the year ends.

Form 3 allows analysis of municipal losses in revenue from each property caused by three factors: (1) renting properties for a below-market rent, (2) the difference between the average market-specific vacancy and the current vacancy at the property, and (3) unpaid rent. Having these data, property managers and asset managers would be able to develop specific measures in order to reduce losses from the difference between the potential revenue and the effective one.

Form 4: Schedule of Cash Flow, by Months, for Year 1998 (Property Level)

This form, in Annex 6, monitors all revenue and all expenses and resulting net cash flows for each property at monthly basis. These cash flows may be used to analyze the relative contribution of different income and expense factors into overall financial results. Annual totals are used to estimate profitability of the property (by calculating annual capitalization rates—see the bottom part of Form 4 and Form 5, columns 17 and 19).

Form 5: Major Property and Performance Characteristics, for Year 1998 (Portfolio Level)

This form, in Annex 7 provides an annual summary, based on data from all previous forms, for asset managers. It allows information to be extracted and sorted by various backgrounds: by management organizations, by types of properties, by use of properties or their values, by profitability, etc.

III. LONGER TERM INFORMATION NEEDS AND ANALYTICAL TOOLS

As discussed in the first report, financial analysis of investment in real estate is based on the idea of available alternative investments: instead of investing in the property in question, an investor might use other

income-generating options (to buy state securities or to open a deposit account at a bank, etc.), and the decision criteria is which option brings a higher return. If the investor already owns some income property, his question is: would he be better off if he sells this property and invests proceeds in something else or pays off his most expensive debts.

A possible model for a Discounted Cash Flow Analysis for some scenarios of such kind, adapted for the case of municipal private property in Dobrich, is presented in Form L1, in Annex 8. Two scenarios are presented:

! **Scenario 1** (A Holding Real Estate) considers the following chain of events:

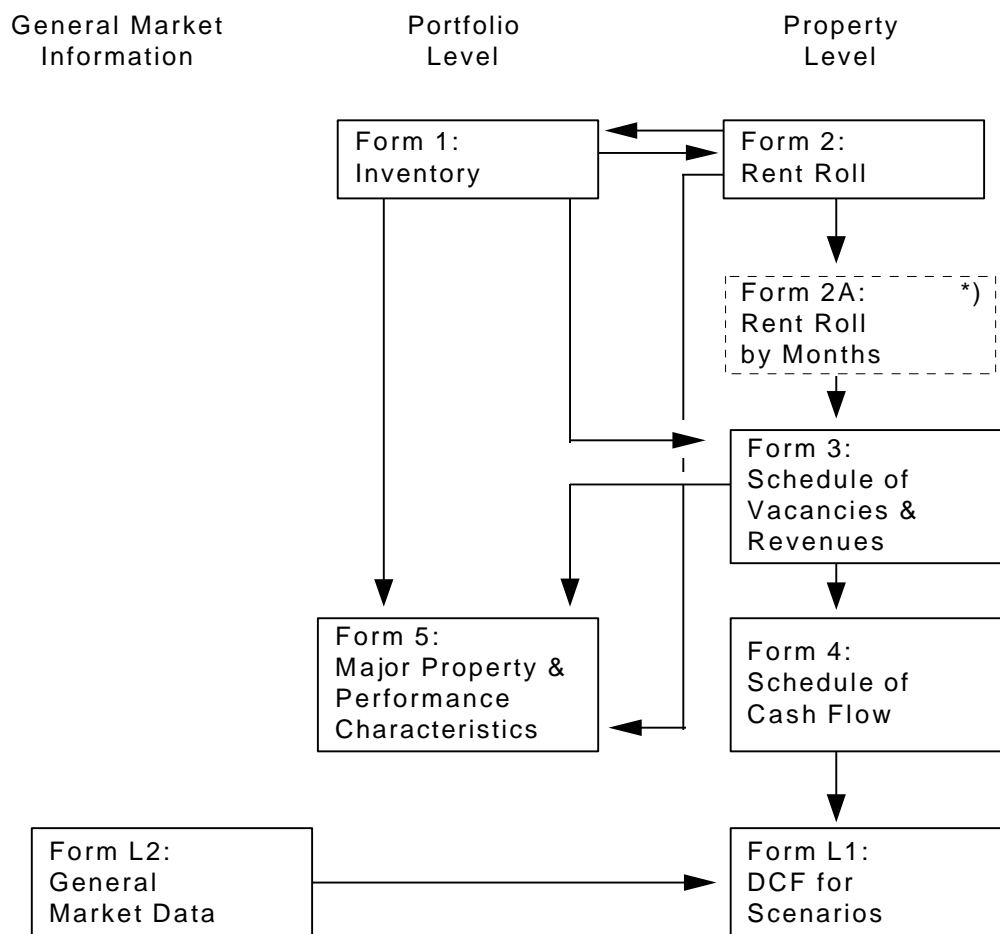
- C The City acquires some property from the state (bearing some expenses related to transferring the property from state to municipal ownership).
- C It holds this property for three years, using it as a rental income property.
- C It sells the property after three years.

! **Scenario 2** (A Alternative Investment) considers another option:

- C The City acquires the same property from the state (bearing the same expenses related to transferring the property from state to municipal ownership).
- C It sells the property immediately after acquisition (bearing some sale cost).
- C It invests proceeds from this sale in state securities or as a bank deposit.
- C It receives the principal back after three years.

The model allows us to calculate Net Present Value (NPV) and Internal Rate of Return (IRR) for cash flows for both scenarios.

However, to use this model, an investor must be able to predict a future cash flow from the property in question and from an alternative investment. So, a prudent use of this methodology assumes some level of maturity and stability of the real estate market and the capital market, which means, first of all, that future rental and sale prices on real estate are reasonably predictable and that returns and risks associated with alternative investments are also predictable based on past statistics. In emerging markets, such as in Bulgarian cities, some of these pre-conditions are not yet fulfilled (for example, sale prices on some types of real property are not presently established in the market, inflation of real estate prices is not predictable, etc.).

Figure 1. The Block-Scheme for the Database

*) May be added to the database

At this stage of the market development, it would be useful to begin to collect systematic data concerning the real estate market (a minimum list is presented in Form L2, Annex 9). After several years, when some historic data would be available and market tendencies become more predictable, such comprehensive methods as the Discounted Cash Flow Analysis would then be applicable.

ANNEX 1

SUMMARY STATEMENT OF THE DELIVERABLE

Description

This tool is a report that represents the second part of the project and provides practical suggestions concerning information needed to improve asset management in the City.

The report suggests some Excel-format information forms for data collection at the property and portfolio levels, including: inventory data on each property; complete income and expense data; and data on the market value of the property and on the debt secured by the property.

The report also discusses more long-term information needs and a spread-sheet for financial analysis of different investment scenarios, which would be applicable as soon as the real estate market becomes more developed and the national economy stabilizes.

The reader of this report should be familiar with Part 1.

Objective of the Tool

The objective of this material is to help Dobrich and other cities to improve asset management for municipal properties through the development and maintenance of inventory and accounting systems, and analytical models for financial analysis.

Value of the Tool

Utilizing municipal non-residential surplus property as income property is a new type of activity for Bulgarian municipalities. The value of the tool is in providing formats for a complex database which is needed in order to increase asset management efficiency.

Users of the Tool

This tool is needed for municipal officials responsible for supervising municipal assets and for municipal specialists assigned to implement the database.

Who Should Read This Deliverable

This deliverable should be read by the officials and specialists identified as Users. Members of City Councils, property managers and others who are interested in technical details and information needs may also find the report useful.

ACKNOWLEDGMENTS

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The principle author of the deliverable is Olga Kaganova of the Urban Institute.

User Profile

The tool will be used by deputy mayors, department heads, information system specialists, and portfolio managers as guidance for developing and implementing a database that will support the management of municipal surplus property. It will provide information to municipal decision-makers for informed asset management decisions (on holding/disposing properties, evaluating performance of portfolio managers, etc.).

Setting and Context

This tool is prepared for the Municipality of Dobrich, which has the same structure and functions as other Bulgarian municipalities. Dobrich has a population of 114,000 people.

Implementation and administration of the database will be developed mainly by the Municipality itself. A general framework is that the Mayor appoints one of his Deputies to supervise the process, and the Deputy appoints the work group (for example, the Head of Privatization Department, an Information System specialist, and a manager of one of the portfolios) to plan and monitor the implementation. The portfolio managers will be responsible for collecting data on their portfolios.

It is assumed that needed administrative decisions will be made and, if required, approved by the City Council.

Value Statement

Through this deliverable the Municipality obtains a practical tool for inventorying surplus properties which it owns (including their values), monitoring all municipal revenues and expenses related to these properties, and estimating the profitability of the properties. In the long run, this will strengthen the municipal revenues base related to real property.

For implementation, the Municipality needs to make some organizational decisions concerning database administration, and also decisions on accounting and reporting standards for property portfolios.

Statement of the Problem Addressed by the Deliverable

The City of Dobrich continues to be the major owner of surplus non-residential properties. However, it still lacks a relevant system of inventorying its property and monitoring revenues and expenses, and objective information for strategic and operating decisions concerning portfolios and properties. This deliverable addresses the specific issues of developing information for more informed decision-making. However, it should be used together with the guidelines presented in the Part 1 and Part 3 deliverables of this project.

Transferability

The suggested set of information forms and the financial spread-sheet will be applicable in other Bulgarian cities. However, the implementation may be organized differently, and may require different local administrative decisions. Suggested information forms may be slightly modified depending on additional specific interests of the local government.

Training Abstract

This deliverable can be read and generally understood by municipal officials and specialists who do not have specialized training. The lone exclusion is Form L1 which assumes some knowledge of the discounted cash flow technique.

However, this deliverable is not an independent product, and efficient implementation of all deliverables within the project would require some training. This issue is addressed in detail in the Part 3 deliverable.

Organization and Content of the Deliverable

Improving the Municipal Asset Management System in Dobrich. Part 2: Information Requirements for Managing Municipal Real Property Assets

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ANNEX 9

Dobrich Municipal "Private" Property Database, Property Level Form L2: Data Required for Long Term Analysis

	Year 1	Year 2	Year 3	Year 4
Consumer price index (CPI)				
Inflation of rental prices				
Inflation of sale prices				
Inflation of operating expenses				
Average vacancy rate				
Returns on alternative investments				
Returns on real estate investment				